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The New Provisions of the Income Tax Law

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(New York Office)

The purpose of this article is to summarize the principal changes in the income tax law effected by the Revenue Act of 1936 which became law on June 22, 1936.

The income tax provisions of the Revenue Act of 1936 apply to taxable years beginning after December 31, 1935. The Revenue Act of 1935 likewise applied to taxable years beginning after December 31, 1935 and that Act is, accordingly, superseded by the new law.

Corporation Taxes

The new law imposes two separate income taxes on corporations in general, (1) a normal tax, and (2) a surtax on undistributed profits.* The normal tax is computed on "normal-tax net income," which is arrived at as follows:

Net income, as defined in the statute (gross income, less allowable deductions) .... $......

Less:

1. Interest on obligations of the United States or of its corporate instrumentalities, which is included in gross income .... $......
2. 85 per cent. of the amount received as dividends from domestic corporations which are subject to income tax (with exceptions relating to dividends from China Trade Act corporations and from corporations deriving a large percentage of their income from U. S. possessions)... ......
3. Dividends paid credit for "mutual investment companies"..... ......

Total of 1, 2 and 3....... ......

Normal-tax net income........... $......

The normal tax is computed at the following graduated rates on normal-tax net income:

Income	*Rates of tax*
0–$ 2,000	8 per cent.
$ 2,000– 15,000	11 Do
15,000– 40,000	13 Do
Over 40,000	15 Do

Banks, as defined in the Act, are taxable at the flat rate of 15 per cent., instead of at the above graduated rates.

Under the prior law, 90 per cent. of domestic dividends was deductible in arriving at "net income," leaving 10 per cent. taxable at 15 per cent. to the extent that the net income exceeded $40,000, resulting in a tax of 1½ per

* See a subsequent paragraph on "Corporations Exempt from Surtax."

cent. on the dividends received. Under the new law the corresponding tax is 15 per cent. of 15 per cent. of the dividends received, resulting in a tax of 2¼ per cent.

Under the new law, the deduction of 85 per cent. of the dividends received is a deduction from "net income" in arriving at "normal-tax net income" and is not (as under the prior law) a deduction in arriving at "net income." Consequently, for the purposes of other sections of the law which refer to "net income," dividends received are not deductible. For example, the limitation on the credit for foreign taxes paid is based upon "net income," not "normal-tax net income."

Surtax on Undistributed Profits

The new law imposes a tax at graduated rates on "undistributed net income," which is arrived at as follows:

Net income, as defined in the statute (gross income, less allowable deductions)		$......
Less:		
1. The normal corporation tax	$......	
2. Interest on obligations of the United States or of its corporate instrumentalities	......	
3. Special deductions in the case of bank affiliates and national mortgage associations	......	
Total of 1 to 3		......
Adjusted net income		$......
Less:		
4. Dividends paid credit	$......	
5. Credit relating to contracts restricting payment of dividends	......	
Total of 4 and 5		......
Undistributed net income		$......

The surtax on undistributed profits is computed on the "undistributed net income," but the rates are graduated according to the ratio of the "undistributed net income" to the "adjusted net income," which as shown above is before the deduction of the credit for dividends paid and for contracts restricting dividends.

The following computation shows the rates of tax, assuming that the "adjusted net income" is $1,000,000 and the "undistributed net income" is $700,000:

Percentage of Adjusted Net Income	Amount of Undistributed Net Income in Each Bracket	Rates of Tax	Amounts of Tax on Undistributed Net Income
1st 10 per cent...	$100,000	7	$ 7,000
10 —20 Do ..	100,000	12	12,000
20 —40 Do ..	200,000	17	34,000
40 —60 Do ..	200,000	22	44,000
Over 60 Do ..	100,000	27	27,000
	$700,000		$124,000

A specific credit is allowed to corporations with "adjusted net income" of less than $50,000. The effect of the credit is to tax the first $5,000 of the "undistributed net income" at the lowest rate of 7 per cent. Assume that a corporation has "adjusted net income" of $30,000 and "undistributed net income" of $6,000. Without applying the credit, the surtax would be $570 [7 per cent. of the first $3,000 ($210) plus 12 per cent. of the next $3,000 ($360)]. By applying the credit, the tax is 7 per cent. of the first $5,000 or $350 plus 12 per cent. of the remaining $1,000 or $120, a total surtax of $470.

Dividends Paid Credit

The "dividends paid credit," as shown in a preceding tabulation, is a deduction from "adjusted net income" in arriving at the "undistributed net income," which is subject to the surtax on undistributed profits. The "dividends paid credit" consists pri-

marily of dividends *paid* during the taxable year. The date of declaration of the dividend, and the record date are immaterial; only dividends actually paid during the taxable year may form part of the "dividends paid credit" for such year, except that there is a dividend carry-over provision, which is described below.

It follows that most corporations will be obliged to estimate in part the "adjusted net income" for the taxable year if they wish to distribute all (or a large portion) of such income during the taxable year in order to avoid (or minimize) the surtax. Some corporations may find it desirable to take a physical inventory at a date perhaps two months before the close of their accounting periods in order to estimate better the adjusted net income for the year.

The law contains no relief provisions to cover cases where it is discovered after the close of the year, as a result of a Treasury audit or otherwise, that the "adjusted net income" was greater than determined by the company, nor are there any provisions to cover cases where the actual net earnings are substantially less than the statutory net income because of nondeductible capital losses, etc. This is one of the obvious inequities of the law.

Unlike the penalty tax on corporations availed of for avoidance of surtaxes on stockholders and unlike the personal holding company surtax, the law contains no provision permitting the avoidance of the surtax on undistributed net income by including all the corporate income in the returns of the shareholders.

If the dividends paid for any taxable year exceed the adjusted net income for such year the excess may be deducted as part of the dividends paid credit in the first succeeding taxable year, and to the extent not needed, as a dividends paid credit in such first succeeding year, they may be deducted as part of the dividends paid credit in the second succeeding taxable year. No credit is allowable for dividends paid in a taxable year beginning before January 1, 1936.

If a dividend is paid in property other than money (including stock of the corporation if held by the corporation as an investment) the dividends paid credit is the tax basis of the property to the corporation or the fair market value of the property at the time of payment, whichever is lower. The parenthetical clause indicates that it is not intended to treat as a tax-free stock dividend a dividend paid in a corporation's own stock if held as an investment. It seems very doubtful whether the courts would sustain a tax on such a dividend merely because the stock was held as an investment. The 1936 law provides, however, that if a distribution is not a taxable dividend to the shareholders it shall not be part of the dividends paid credit.

If a dividend is paid in obligations of the corporation, bonds for example, the dividends paid credit is the face value of the obligation or its market value, whichever is lower. If the fair market value is lower, then when the obligation is redeemed the excess of the redemption price over such fair market value is allowed as part of the dividends paid credit in the year of redemption, to the extent that it is not allowable as a deduction in computing net income for any taxable year.

Stock dividends and stock rights are deductible as part of the dividends paid credit at their fair market value only if they constitute taxable dividends to the shareholders.

One section of the law [27 (f)] provides that the part of distributions in liquidation which is properly chargeable to the earnings accumulated after February 28, 1913 shall be treated as a taxable dividend paid for the purpose of the dividends paid credit. The law does not state how to determine the portion of liquidating dividends which is properly chargeable to earnings. This section [27 (f)] apparently conflicts with another section [27 (h)], which provides that no dividends paid credit shall be allowed with respect to any part of a distribution which is not a taxable dividend to the shareholders, as profits on liquidations are capital gains rather than taxable dividends. The latter section [27 (h)] was probably intended to apply to distributions other than the liquidating distributions referred to in section 27 (f), and it would appear that in any event distributions in liquidation would be controlled by section 27 (f), which refers specifically thereto.

In order to form part of the dividends paid credit the dividends must be paid pro rata on all shares of a particular class.

Contracts Restricting Payment of Dividends

In addition to the dividends paid, the law allows as a deduction in arriving at "undistributed net income" the larger of the two following credits: (1) the portion of the adjusted net income which cannot be distributed within the taxable year without violating a provision of a written contract executed prior to May 1, 1936, dealing expressly with the payment of dividends; (2) the portion of the earnings of the taxable year paid in discharge of a debt incurred before May 1, 1936, or irrevocably set aside within the year for the discharge of such a debt, provided that the corporation is required to pay or set aside such amounts by a written contract executed prior to May 1, 1936, dealing expressly with the disposition of earnings of the taxable year.

Consideration will naturally be given to whether a corporation's charter is a contract within the meaning of the above credit provision. If it is assumed to be such a contract, many corporations will be entitled to a credit because of provisions in their charter regarding the payment of dividends. A further consideration arises where the charter does not refer specifically to dividends but binds the corporation to comply with state laws which do deal expressly with the payment of dividends.

Corporations Exempt from Surtax

The surtax on undistributed profits does not apply to domestic corporations which for any portion of the taxable year are in bankruptcy under the laws of the United States, or are insolvent and in receivership in federal or state courts. The surtax likewise does not apply to banks (as defined in the Act), insurance companies, foreign corporations, certain corporations deriving a large percentage of income from United States possessions, China Trade Act corporations, and Joint Stock Land Banks.

Dividends

Under the new law a dividend is taxable to a shareholder if paid out of the earnings of the taxable year, even though a corporation has a deficit at the beginning of the year in excess of the earnings for the taxable year. In determining whether the earnings of the taxable year are sufficient to cover

the dividends, the law provides that the earnings be computed for the year as a whole, without prorating to the dates of the dividend payments. The foregoing provisions of the law, accordingly, tax dividends which may in fact be paid out of capital or paid-in surplus. A tax on such dividends is of doubtful constitutionality, but if it should be held that such dividends are not taxable to the shareholders, the corporation would secure no credit for such dividends for the purpose of the surtax on undistributed income.

The new law taxes all stock dividends or dividends in rights to the extent permitted by the Sixteenth Amendment to the Constitution. Dividends paid in common stock on common stock or rights given to common stockholders to subscribe to common stock will still be nontaxable under Supreme Court decisions. Dividends paid in common stock on preferred stock will be taxable. If a distribution is payable at the election of any of the shareholders in either (a) stock or rights which would be tax-free, or (b) money or other property (including stock and rights) of a type that would not be tax-free, the distribution will be taxable under the new law.

Dividends will be taxable to individual shareholders for both normal-tax and surtax purposes.

Liquidation of Subsidiaries

The 1935 law permitted the tax-free liquidation of a subsidiary to the extent that no money was received, but the tax basis of the subsidiary's assets in the hands of the parent company was the same as the tax basis of the parent company's investment in the stock of the subsidiary. Consequently in most cases the tax on any profit realized from the liquidation of subsidiaries was merely deferred. Under the new law a real tax-free liquidation of subsidiaries is permitted. Money is not excluded from the property which may be received tax-free by the parent company in a liquidation. Neither gain nor loss is recognized. The tax basis of the assets of the subsidiary is the same in the hands of the parent as it would have been in the hands of the subsidiary.

Several requirements of the statute must be met in order to have a tax-free liquidation of a subsidiary. From the time the plan of liquidation is adopted until it is completed, the parent company must own stock possessing at least 80 per cent. of the total combined voting power of all classes of stock entitled to vote and 80 per cent. of the total number of shares of all other classes of stock, except nonvoting stock which is limited and preferred as to dividends. The effect of another provision is to prevent the parent company from disposing of any stock of the subsidiary after the plan of liquidation is adopted. No distribution must be made before the first day of the first taxable year of the corporation beginning after December 31, 1935. The liquidation must be completed within the taxable year unless a plan of liquidation is adopted providing for the distribution of the assets within three years from the close of the taxable year during which the first distribution is made. If the liquidation is not completed within the taxable year, the Commissioner may require a bond or waiver of the statute of limitations, or both, to protect the government in case the liquidation when completed does not satisfy the statutory requirements.

The assets of the subsidiary must be distributed in cancellation or re-

demption of its capital stock. If the subsidiary is insolvent, for example, and distributes assets to the parent company to apply on indebtedness to the parent company, the provision regarding tax-free liquidation does not apply.

The new law offers additional incentive to liquidate subsidiaries. In addition to the increase in the tax on intercompany dividends, it will be necessary under the new law to estimate separately the income of each subsidiary company if it is desired to avoid the undistributed profits tax by distributing all the income of the subsidiaries during the taxable year.

Gain to Individual Shareholders from Liquidations

Under the prior law, a gain realized by a shareholder, other than a corporation, from the receipt of distributions in liquidation of a corporation was 100 per cent. taxable regardless of the length of time the stock was held, but if a loss resulted only a percentage of the loss may have been deductible, depending upon the period of time held. The new law provides that, if the distributions are in complete liquidation of a corporation, the gain realized by a shareholder, other than a corporation, is taxed in the same manner as a gain realized from the sale of securities; i.e., if the stock has been held for more than one year only a portion of the gain is taken into account in computing net income, the portion dropping to 30 per cent. where the stock has been held for a period of more than ten years.

In order to secure the benefits of this provision there must be a plan of liquidation under which the distribution of the assets is to be completed in not more than two years from the close of the taxable year in which the first distribution is made.

The new provision applies only to complete liquidations. In the case of partial liquidations, as for example a retirement of preferred stock, the gain will still be 100 per cent. taxable.

Mutual Investment Companies

The new law accords special treatment to investment trust corporations of the open-end type which meet the definition in the statute of a "mutual investment company." If such corporations satisfy the requirements of the statute, then in computing the *normal* corporation tax, in lieu of the deduction of 85 per cent. of the domestic dividends *received* such corporations are allowed a deduction of the same credit for dividends *paid* as is allowed to other corporations for the purpose of the surtax on undistributed income, except the privilege of carrying forward the dividends paid in excess of the adjusted net income. This means that if such a corporation distributes all of its income it will be liable for no federal income taxes whatever. It will, however, be subject to the capital stock tax and excess-profits tax. Unincorporated investment trusts which have been classed as associations, and hence taxed as corporations, may also be entitled to the benefits of this provision.

The following requirements of the statute must be met: (1) the company must not be a personal holding company within the meaning of Section 351; (2) the company must be organized for the purpose of, and substantially all its business must consist of, holding, investing, or reinvesting in stock or securities; (3) at least 95 per cent. of its gross income must be derived from dividends, interest, and

gains from the disposition of stock or securities; (4) less than 30 per cent. of its gross income must be derived from the disposition of stock or securities held for less than six months; (5) not less than 90 per cent. of its net income must be distributed to its shareholders during the taxable year as taxable dividends; (6) its shareholders must be entitled, upon reasonable notice, to redemption of their stock for their proportionate interests in the corporation's properties, or the cash equivalent thereof less a discount not in excess of 3 per cent. thereof.

After July 22, 1936, the following additional requirements must be met throughout the taxable year: (1) not more than 5 per cent. of the gross assets, taken at cost, may be invested in securities of any one corporation, government or subdivision thereof, excepting obligations of the United States or corporate instrumentalities thereof; (2) not more than 10 per cent. of the outstanding securities of any one corporation may be owned; (3) the company may not have outstanding bonds or indebtedness in excess of 10 per cent. of its gross assets taken at cost; (4) the company must comply with any rule or regulation prescribed for the purpose of ascertaining the actual ownership of its stock.

Because of the above requirements, a company may be a "mutual investment company" in one taxable year, but may not satisfy the requirements in another taxable year.

Mutual investment companies are subject to the surtax on undistributed income, computed in the same manner as in the case of other corporations.

Property Acquired in a Reorganization

The prior law provided that in the case of property acquired in a reorganization the tax basis was the same as in the hands of the transferor if no gain or loss was recognized to the transferor, provided an interest or control of 50 per cent. or more remained in the same persons. The new law eliminates the requirement of a continuing 50 per cent. interest or control and in all cases of property acquired in a reorganization the basis is the same as in the hands of the transferor, increased by any gain or decreased by any loss recognized to the transferor. The change in the tax basis applies only to property acquired in a taxable year beginning after December 31, 1935.

Deduction of Excess-Profits Tax

The new law permits the deduction of the excess-profits tax in determining both the "normal-tax net income" on which the corporation normal tax is computed and the "undistributed net income" on which the corporation surtax is computed. The income tax is not allowed as a deduction in determining the net income upon which the excess-profits tax is computed.

Nonresident Aliens

A nonresident alien individual not engaged in trade or business within the United States and not having an office or place of business therein is not taxable on capital gains under the new law. Such an individual is taxable only on the periodical income from United States sources to which the withholding provisions apply, including dividends. He is entitled to no deductions, credits or exemptions, and the rate of tax is a flat 10 per cent., except that in the case of a resident of Canada or Mexico the rate may be reduced by treaty to not less than 5 per cent. The Treasury is authorized to

exempt such individuals from the requirements of filing returns, by regulations. Withholding is required at the rate of 10 per cent. on and after July 2, 1936, with respect to periodical income, *including dividends,* unless the rate is reduced by treaty with Canada or Mexico. Heretofore no withholding has been required with respect to dividends.

The phrase "engaged in trade or business within the United States" does not include trading in securities or commodities through a resident broker, commission agent, or custodian. If a partnership is engaged in business or has an office in the United States, the members of the partnership are considered to be engaged in business or to have an office here.

If a nonresident alien individual is engaged in trade or business in the United States or has an office or place of business therein, his taxable income is computed as under the prior law. He is taxable on all income derived from sources within the United States at the regular normal and surtax rates with a $1,000 exemption.

Foreign Corporations

A foreign corporation not engaged in trade or business within the United States and not having an office or place of business therein is not taxable on capital gains under the new law. As in the case of nonresident aliens similarly situated, such foreign corporations are taxable only on the periodical income from United States sources, including dividends, to which the withholding provisions apply. Such a foreign corporation is entitled to no deductions, credits or exemptions, and is not entitled to the credit of 85 per cent. of domestic dividends received. The rate of tax is 15 per cent. on income other than dividends. The rate of tax on dividends is 10 per cent., except that in the case of Canadian or Mexican corporations the rate may be reduced by treaty to not less than 5 per cent. The Treasury is authorized to exempt such corporations from the requirements of filing returns, by regulations. Withholding is required at the rate of 15 per cent. on income other than dividends, and at the rate of 10 per cent. on dividends, unless the latter rate is reduced by treaty with Canada or Mexico.

As in the case of nonresident aliens, a foreign corporation is not engaged in business within the United States merely because it trades in securities or commodities through a resident broker, commission agent, or custodian.

If a foreign corporation is engaged in trade or business within the United States or has an office or place of business therein, it is taxable on all its income from sources within the United States as heretofore. Such a corporation is entitled to deductions from income as heretofore and is entitled to the credit of 85 per cent. of domestic dividends received.

A foreign corporation, whether or not engaged in business in the United States, is *not* subject to the surtax on undistributed net income. Many corporations doing business in foreign countries through United States corporations or branches thereof will consider the desirability of conducting the foreign operations through foreign corporations, where it is not possible or desirable to distribute all income as dividends. As heretofore, foreign corporations will be subject to the penalty tax on unreasonable accumulations of earnings, if such corporations derive income from sources within the United States and provided they are formed or

availed of for avoidance of the United States surtax on stockholders.

Credit for Foreign Taxes

No specific change has been made in the credit for foreign taxes paid. In the case of corporations the credit should be allowable against the combined normal tax and surtax on undistributed income. However, as a result of a change in the method of computing net income the limitation on the credit for foreign taxes will differ from prior laws. One of the limitations, e.g., is the ratio of income from foreign sources or dividends from a foreign subsidiary to entire net income. Under the new law all dividends received from domestic corporations form part of the entire net income and the credit for 85 per cent. of such dividends is only a credit against corporate net income for normal tax purposes and not as formerly a deduction from gross income. Consequently, the entire net income may be larger than under prior laws and the credit, by limitation, may be smaller.

A domestic corporation which derives income from foreign sources upon which the tax is withheld at the source may be subject to the surtax on undistributed income even though it distributes all the income actually received (net of the tax withheld) because if the foreign tax is treated as a credit rather than a deduction from income it does not reduce the "undistributed net income."

Penalty Tax on Accumulations of Surplus

In addition to imposing the surtax on undistributed income, the new law retains the penalty tax on corporations formed or availed of for the purpose of preventing the imposition of the surtax upon their shareholders through the medium of accumulating profits. If the corporation is subject to the regular surtax on undistributed net income, the rate of the penalty tax (which is imposed in addition to such surtax) is 15 per cent. of the first $100,000 of retained net income and 25 per cent. of the balance. If the corporation is not subject to the regular surtax on undistributed net income, the rate of the penalty tax is 25 per cent. of the first $100,000 of retained net income and 35 per cent. of the balance.

The penalty tax may be avoided if all the shareholders report their share of the corporation's retained net income in their original returns, but under the new law at least 90 per cent. of such retained net income must be reported by shareholders other than corporations.

Disallowed losses from the sale or exchange of capital assets, though not allowed as a deduction in computing the "undistributed net income" which is subject to the regular corporation surtax, are allowed as a deduction in computing the "retained net income" for the purpose of the penalty tax.

Surtax on Personal Holding Companies

The new law also retains the surtax on personal holding companies controlled by five families or less. This surtax is imposed in addition to the regular corporation surtax on "undistributed net income." The new rates are graduated from 8 per cent. of the "undistributed adjusted net income" not in excess of $2,000 to 48 per cent. of the amount in excess of $1,000,000. The tax does not apply if 90 per cent. or more of the adjusted net income is

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The Windfall Tax and Refunds of AAA Taxes

By W. C. Magathan

(*Washington Office*)

The subject of the taxes enacted by the Agricultural Adjustment Act is treated in three separate titles of the Revenue Act of 1936. Title III provides for the so-called windfall tax, which is in effect the recapture of a portion of the AAA taxes declared unconstitutional, and might well be called The Recapture Tax. Title IV deals with the refund of AAA taxes levied on exports, deliveries for charitable distribution or use, and in certain other special cases, and with refunds on floor stocks as of January 6, 1936. Title VII deals with the refund of AAA taxes to processors.

It is obviously impossible to discuss all of the various questions which are presented by the three titles above-mentioned. The scope of this article will permit only a general analysis of the three titles, and a brief discussion of the more obvious situations presented.

Refunds of Amounts Collected Under the Agricultural Adjustment Act

The refunds covered by Title VII are those which were provided for as to processors by Section 21 of the Agricultural Adjustment Act as amended. The Senate Finance Committee report states that this title consists entirely of a revision of Section 21 (d) of the Agricultural Adjustment Act and related provisions. The need for such revision was stated by the Committee to be imperative because of the heavy administrative burden if claims were required to be passed on under the provisions of Section 21 (d) of the AAA as amended. It was said that there were possible claims for $960,000,000 in amount and more than 1,000,000 in number with respect to all of which Section 21 (d) would require the Commissioner to hold formal judicial hearings. The Committee also stated that apart from these administrative considerations there were important legal considerations. Reference was made to more than 200 pending court suits which challenge the validity of Section 21 (d) in a number of respects, such as failure to provide affirmative right to a refund; being so vague and indefinite as not to provide an adequate remedy at law; because it forbids a refund with respect to any amount if any part of such amount is passed on; and because the Commissioner was not required to act on the claim within any fixed period of time.

The new law lays down the basic principle that no refunds may be made of amounts collected under the Agricultural Adjustment Act except to the extent that the claimant establishes that he bore the burden of such so-called taxes, either by absorbing them or by repaying them unconditionally to his vendee.

The law requires that claims shall be filed *after* the passage of the revenue act and prior to July 1, 1937. Although many claims have been filed under the Agricultural Adjustment Act, the new law contemplates that new claims shall be filed because of the differences in the laws. The Commissioner may require a single claim to cover the entire period during which processing taxes were paid.

A special statute of limitations is

provided for court actions with respect to "any amount paid by or collected from any person as tax (except as processing tax, as defined herein) under the Agricultural Adjustment Act." No such suit or proceeding may be brought within eighteen months from the date of filing of the claim, unless the Commissioner has within that period rendered a decision on such claim. Also, no such suit or proceeding may be brought after two years from the date of the registered notice of disallowance. The language of the section is apparently intended to cut off those suits now pending in the courts since it relates to suits "whether brought *before* or *after* the date of the enactment of this Act."

The new law sets up a complete system of review for claims, with respect to the "processing tax." Processing taxes are defined as follows:

> The term "processing tax" means any tax or exaction denominated a "processing tax" under the Agricultural Adjustment Act, but shall not include any amount paid or collected as tax with respect to the processing of a commodity for a customer for a charge or fee.

The procedure is somewhat akin to that now existing for deficiencies of income taxes, but there are certain important differences. The Commissioner must act administratively on the claims within three years from the date of filing. This three-year period may be extended by written consent of the claimant. The claimant is notified of the action of the Commissioner by a registered notice. This allowance or disallowance is to be final, unless within three months the claimant files a petition requesting a hearing on the merits of the claim in whole or in part by a Board of Review established for such purpose in the Treasury Department. A hearing is then to be set before the Board of Review within three months after the filing of the petition for a date not more than two years from the filing of the petition. Such hearing is to be held in Washington or in the claimant's local collection district, or such other place as may be stipulated.

These hearings are to be conducted much like hearings before the Board of Tax Appeals, and findings of fact and decisions are to be rendered in much the same way. These decisions may be appealed to the United States Circuit Courts of Appeal. Appeal may then be taken by writ of certiorari to the Supreme Court of the United States in proper cases. No other method of proceeding in court is provided for, whether brought *before* or *after* the enactment of the Act. Thus, suits already pending are apparently sought to be made of no avail under this system.

The law establishes certain rules and presumptions as to evidence with respect to whether the claimant bore the tax or passed it on to others. It is provided that it shall be *prima facie* evidence that the claimant bore the tax if the "average margin" per unit of the commodity processed was lower during the tax period than the "average margin" during the period of twenty-four months before and six months (February to July, 1936) after the tax. If the "average margin" during the tax period was not lower, then this is to be considered as *prima facie* evidence that the claimant shifted the tax to others. These presumptions are rebuttable, so that the claimant may establish by other evidence that he did bear the tax, even though the average margin for the period was not lower and he is therefore entitled to the refund.

Refunds Involving Charitable Distributions, Exports, and Floor Stocks

Certain sections of the Agricultural Adjustment Act are reenacted so as to permit the refunds therein provided for. These classes of refunds are as follows:

1. Deliveries for charitable distribution or use. (Sec. 15 (c) AAA.)
2. Adjustments relative to exemptions of certain products such as large cotton bags. (Sec. 15 (a) AAA.)
3. Adjustments due to decreases in tax rates. (Sec. 16 (e) (i) AAA.)
4. Refunds incident to suspensions of taxes or exemption of certain products. (Sec. 16 (e) (3) AAA.)
5. Refunds on products exported. (Sec. 17 (a) AAA.)

All of these refunds except those under 15 (a) may be allowed only to claimants other than the processors who paid or were liable for the tax. Refunds to processors are provided for under Title VII, discussed above. Refunds are not to be allowed if prior to January 6, 1936, the amount claimed has been used as a credit. Also no refund may be allowed except to the extent the claimant establishes that he has not received and is not entitled to receive reimbursement from the processor or other vendor on such articles.

All such claims must be filed prior to January 1, 1937, and no claim may be allowed in an amount less than $10.00. Interest is not to be allowed, and there is to be no review by the Comptroller General or other official of the Commissioner's findings except in case of fraud or mathematical errors. Also no court review is authorized.

The law provides that refunds of AAA taxes on floor stocks shall be paid to those who first held for sale or other disposition (including manufacturing or further processing) on January 6, 1936, floor stocks processed wholly or in chief value from a commodity subject to processing tax.

The refund is to be an amount equal to the processing tax which would have been payable on such article if it had been processed on January 6, 1936, but not in excess of the tax shifted to the claimant on such article, reimbursements being considered; and not in excess of the amount of the tax burden on such stocks which the claimant has not passed on to his vendees and has not included in his sales prices. Such claims must be filed before January 1, 1937.

Questions Raised as to AAA Tax Refunds

The most important question raised is that of constitutionality—whether the Government can retain any part of a tax which was wrongfully or illegally collected, irrespective of whether the burden of such tax was shifted or not. It is recognized that the Agricultural Adjustment Act provided that no refund would be allowed where the tax was shifted, but this provision contemplated a lawful tax. Likewise, in its report, the Senate Finance Committee referred to a similar rule adopted with respect to the automobile accessories tax. There, also, a lawful tax was involved. It would seem that if a tax is unlawfully collected, the one who paid the unlawful exaction to the Government has the right to its return. If such exaction has been passed on, then the question may arise whether or not those who bore the tax have a right of action over against the taxpayer.

The second important question is the apparent attempt to cut off those taxpayers who have already filed claims, and in some instances suits in the

courts. The law contemplates that they must refile their claims and be governed by the provisions of the present act. If perchance by some "fluke" they are at present barred, they are "out of luck."

As to refunds of so-called "Floor Stocks Taxes," no right of review in court is given because "the refunds will be made to persons other than those who paid or were liable for payment of the tax under the Agricultural Adjustment Act as amended, and the present doubt as to the legal status of such claims"; and because the provision "is purely remedial and provides a form of relief, which, however justifiable as a matter of equity and sound policy, is not required by law, . . ." These statements made by the Ways and Means Committee again overlook the fact that these exactions were collected as unlawful taxes, and it is questionable whether in good conscience the Government may keep them.

Why interest should not be allowed on these taxes if allowed on others, is not clear except as a measure of public finance.

Windfall Tax

The Act itself does not use the term "windfall," but calls the exaction a "Tax on Unjust Enrichment." It might better be called a "Recapture Tax." The President in his message made the following suggestion for this tax:

> The first (suggestion) relates to the taxation of what may well be termed a windfall received by certain taxpayers who shifted to others the burden of processing taxes which were impounded and returned to them, or which otherwise have remained unpaid.

Congress adopted this suggestion. At first a tax of 90 per cent. of these so-called windfalls was contemplated, but this was finally reduced to 80 per cent. The tax is denominated a special income tax. Though it is aimed at recapturing AAA taxes impounded but not paid, by its terms it was made to apply also to other excise taxes. It is levied on special net income from the three following sources:

1. Net income resulting from taxes not paid but shifted to others.
2. Net income to a vendee resulting from his receiving reimbursement from his vendor for taxes which he has shifted to others.
3. Net income resulting from receiving refunds or credits for taxes which have been shifted to others.

Certain types of income are exempted from this tax. They are:

(1) Income from articles not sold until after the termination of the tax.

(2) Income with respect to articles with respect to which the taxpayer reimbursed his vendee.

(3) Income with respect to refunds or credits other than erroneous and illegal collections such as articles for charitable use or delivery or for articles exported.

To determine the extent to which the taxpayer has shifted the burden of the taxes two methods are prescribed. The first, a *prima facie* method, may be used either by (a) deducting from the selling price of such taxed articles, the sum of the cost of such articles and the average margin with respect to the quantity involved; or (b) the average margin per unit may be determined and this factor used in determining the variation of average margin for the tax period.

The average margin is computed with respect to the taxpayer's sales of similar products in the preceding six years. If a taxpayer has no such period or his average margin cannot be determined as prescribed in the Act, the Commissioner may use the average

margin as determined by him for representative concerns similarly circumstanced.

Either the taxpayer or the Commissioner may rebut the presumption established by the *prima facie* method by showing that the change or lack of change in the margin was due to changes in factors other than the tax; or by showing that contracts of sale were modified, or new contracts were adopted, or changes in prices or size of packages were made, discounts granted, contracts to refund taxes made, or by any other means may show that the taxpayer either bore or did not bear the tax.

The tax is made applicable to taxable years ending during the calendar year 1935 and to subsequent years. A return is to be required of each taxpayer who may be liable for the tax, whether actually liable or not. It is also provided that the tax shall be imposed regardless of any loss of the taxpayer arising from other sources and regardless of whether the taxpayer had a taxable net income for the taxable year for income tax purposes. However, it is provided that if this application of the windfall tax is held invalid, such tax shall apply to that portion of the taxpayer's entire net income for the taxable year, which is attributable to the net income from the three sources specified above.

A credit is permitted against this windfall tax, based on the difference between what the taxpayer's income tax liability would have been with this windfall net income excluded and what it is with such net income included.

Questions Raised as to Windfall Tax

Again, as with the AAA refunds, the outstanding questions relate to the constitutionality of this tax. These are whether this 80 per cent. tax amounts to confiscation, whether it is not so arbitrary and capricious as to be invalid as a tax, whether the reacquisition or retention by a taxpayer of amounts held by the courts to be illegal taxes makes such amounts income within the meaning of the Constitution, and whether the basis set forth for the determination of income is productive of a result which may be said to be income within the meaning of the Sixteenth Amendment.

It may be argued that this tax is not inequitable, but a more serious question is involved; that is, whether the Government can assess illegal taxes and then, when the courts find them to be illegal, turn around by practical confiscation in the guise of a tax on so-called unjust enrichment and in effect take the same money. If this can be done, by what means may citizens resist illegal exactions of their governments? Practically all taxes are passed on—some directly and some indirectly. If a refund is secured for whatever reason, there is in a sense a measure of enrichment. However, until now, it has never been prefixed with the name "unjust."

Hardships and Inequities in the 1936 Tax Law

By J. Marvin Haynes and C. J. McGuire

(Washington Office)

The power to tax is the power to destroy. This statement is as true today as it was when first made by the Supreme Court of the United States. Yet the Congress which passed the Revenue Act of 1936 fabricated therein a weapon which may prove to be the ruination of many corporations. Admittedly, the Act is political in nature, but regardless of that fact its economic unsoundness has been condemned by the unbiased as well as by the biased.

After the Bill passed the House and had been considered by the Finance Committee of the Senate, Senator King of that Committee reported to the Senate:

> The plan proposes an entirely untried system which appears decidedly uncertain as to revenue yield.

He, of course, was speaking of the tax on undistributed profits. His Committee reported out a Bill which, though harsh, at least attempted to place the burden where it would do the least harm. This Bill was passed by the Senate, but it was scrapped in the steamroller tactics adopted in the last few days of Congress.

In his message to Congress on March 3, 1936, calling attention to the need for additional revenue, the President suggested the tax on undistributed profits, stating:

> I invite your attention to a form of tax which would accomplish an important tax reform, remove two major inequalities in our tax system and stop "leaks" in present surtaxes. . . .
>
> The existing difference between corporate taxes and those imposed on owners of unincorporated businesses renders incorporation of small businesses difficult or impossible.

Of course, the primary purpose of the Act was to raise additional revenue. That purpose may be temporarily accomplished. However, the soundness of the law as a "reform" measure or as a "leak" measure is questionable. If corporations are destroyed or materially handicapped financially the Government is the loser. If corporations are prevented from operating they cannot earn income or pay taxes!

There are taxpayers who legitimately avoid taxes. Practically every taxpayer tries to pay the minimum. This situation has existed since taxes were first thought of and it will continue to exist regardless of any strong-arm legislation which may be enacted. The courts have universally held that a taxpayer has the right to protect himself. Some corporations may have accumulated surpluses which were not distributed because of the desire on the part of the stockholders to avoid high surtaxes. But, if so, should the many be penalized because of the few? If one person does something wrong with his right arm should everybody's be struck from him? It is believed that only a small percentage of corporations perpetrated the "evils" complained of. Yet all corporations are affected by the 1936 Act and must suffer under it.

What are some of the most obnoxious features of the Act? In the first place the undistributed profits tax is an experiment—an experiment that undoubtedly will be the source of more

litigation than any tax law which has been enacted to date. It is an experiment which is being made after a Committee of Congress, with the assistance of experts, condemned it. In 1927 the Joint Congressional Committee on Taxation reported:

> The most obvious objection to such a tax is the burden which it places on legitimate and proper business expansion. As a business expands not only does its plant and property increase but a large working capital is required and it is desirable that reasonable accumulations of profits necessary for the expansion and stability of corporations should not be unduly burdened. . . . It is believed that a tax on the total accumulation of profits by corporations is not desirable, because in many cases it might cause the making of unwise distributions and prevent the accumulation of reasonable and proper surplus.

Notwithstanding the foregoing report and notwithstanding the advice of practically every sound economist, Congress has passed the Act and we are faced with it.

Why do we need an experiment when we already have a system of taxation developed over a long period of years which has proved adequate in the past? Taxpayers know what that system is. Corporations are able to estimate with a reasonable degree of accuracy what their tax liability for a given year will be and can formulate their plans accordingly. Financial institutions considering underwritings have been able to know what part of the earnings of a corporation would be paid over to the Federal Government in taxes. Under the present experiment it will be almost impossible to foresee what a corporation's financial picture will be at the end of a taxable year. As a result potential financers will be reluctant to extend credit except under the most conservative conditions.

The fact that the law is an experiment might not be sufficient to condemn it. Its requirements are such, however, that it is obvious many inequities and hardships will result from its operation.

As has been indicated, the purpose of the undistributed income tax is to force corporations to distribute their earnings. With this purpose in mind, Congress provided that to avoid the tax a corporation must distribute its income in the year in which it is earned. In other words, the "dividends credit" is composed only of dividends paid within the taxable year. This means that to avoid the tax every corporation must know before the end of the year what its earnings will be—an impossibility. Most corporations cannot know until many weeks after the close of the year what their income was, and in many instances it has taken the Treasury years to determine the true net income of a corporation for a given year. In many instances the question has been decided only after years of litigation, finally ending in the Supreme Court of the United States.

What is the result? Corporate executives must guess what the earnings of the corporation will be and no matter how honest they are or regardless of what effort they may make to be as nearly correct as possible, the corporation will be penalized if its dividends are not sufficient to absorb its current profits. Scientific taxation should not be made to depend on the accuracy of guesses.

The law was designed to aid the small corporation and the shareholders thereof "who need disbursement of dividends."* No effort was made to distribute the tax burden according to ability to pay. With such an end but

* President's message to Congress.

without a scientific means to accomplish it the probabilities are that the effect of the law will be opposite to its purpose.

Consider, for example, the question of reserves, the accumulation of which is forbidden, except under penalty. How is any business, large or small, able to protect itself against the unforeseen contingencies in years to come? Every prudent man knows that reserves are necessary. A large percentage of our bankruptcies have been caused by lack of adequate reserves or insufficient working capital. Yet under the present law if a corporation is unwilling to submit to the penalty tax, it is prevented from providing for the security of its business, for the protection of its investments or, in some instances, for the employment of sufficient labor. This situation will confront all corporations, large and small, if they do not already have ample surplus to meet their future needs.

We are just coming out of a period of depression and many corporations which have struggled for existence since 1929 are for the first time in a position to go forward with confidence. They have used up their surplus accumulated before the depression occurred and are in a position again to fortify themselves against contingencies which are bound to arise.

The Revenue Act of 1936 prevents such fortifications under penalty. It needs little imagination to conjure what business conditions in this country would have been from 1929 to date if the present law had been in effect in years preceding 1929. As stated in the Minority Report of the Ways and Means Committee:

> Hardly a business would have been left standing; the army of the unemployed would have been more than doubled; the greater part of the population would have been forced on relief.
>
> The reserves which they built up in the prosperous years were alone responsible for enabling thousands of organizations to continue in business during the depression, to provide jobs for millions of persons who otherwise would have been out of work, and to maintain dividend payments.

It is common knowledge that many organizations maintained their dividend payments during years in which the annual dividends were not earned. It is likewise common knowledge that many organizations maintained employment not justified by business conditions in order to ameliorate hardship and suffering. Some of this gratuitous employment was made at the behest of Government officials who publicly appealed to the patriotism of corporate executives.

Another inevitable effect of the tax will be to retard business expansion. This is a serious situation for it will be remembered that all of our great industries today and a large percentage of our small industries are the result, to some extent at least, of expansion programs financed with accumulated earnings. What would be our employment situation today if no corporation in the past had been permitted to expand, except by paying a penalty? What corporation today is willing to pay a penalty to expand or rehabilitate its business? If it is not willing, how can employment be increased so as to absorb the unemployed and thus reduce the relief expenditures which have resulted in the present huge public debt?

Probably one of the greatest hardships in the Act is that which will not permit corporate organizations to pay existing debts out of their earnings without being subjected to the penalty tax. Naturally corporations must pay their debts, or sooner or later they will

be forced into bankruptcy. The law contains no provision for a credit in those cases where earnings are honestly used to pay pre-existing debts, unless the corporation is bound by a contract executed prior to May 1, 1936, expressly dealing with the disposition of earnings. Failure to include such a provision in the law was deliberate, for this situation was called to the attention of the House by the Minority Report of the Ways and Means Committee in the following language:

> By imposing an oppressive penalty on earnings used or set aside to repay debts, the tax not only makes it more difficult for businesses to meet their obligations, but tends to impair the value of the obligations themselves. It is indeed a strange philosophy underlying a tax bill which punishes honesty and integrity and encourages dishonesty and irresponsibility.
>
> The natural result of this policy will be an unfortunate and undesirable restriction on corporate credit, which is already at a minimum. Banks and other creditors will not only tighten up on existing loans, but will impose more strict conditions on new ones. This curtailment of credit will in turn result in a curtailment of business activity, thereby further hampering recovery and reemployment. It will have a particularly depressing effect upon the making of loans for purposes of business rehabilitation and expansion. Thus again we find the bill running at cross-purposes with other avowed policies of the administration.

Because no deduction may be taken from current net income to provide for the payment of pre-existing debts, many corporations will be faced with a dilemma. If they do not pay the debts, liens may be placed against their property and they may be forced into bankruptcy or receivership. If they do pay their debts and as a consequence do not have any funds with which to pay dividends, they will be required to pay the undistributed net income penalty tax. As an illustration, assume corporation A, which has managed to weather the depression, commences the year 1936 with $300,000 capital, but no surplus. It breaks even for 1936 but has a taxable income of $100,000 because of unallowable capital losses. A bank loan of $100,000 matures on December 31, 1936 which the bank refuses to renew. The corporation pays the loan by depleting its current assets.

Unless the corporation pays a dividend of $100,000 (less the normal tax) it will be subjected to a heavy penalty tax despite the fact that it has no net profits and has been forced to deplete its current assets. The same situation obtains in principle in the case of a corporation which has net earnings of $150,000 in 1936 but finds itself with increased inventories and receivables of substantially that amount at the end of the year.

A corporation which incurred a large deficit, during the depression, so that at January 1, 1936 its capital was impaired, is prevented by law from paying dividends from the earnings of 1936 and subsequent years until the impairment is made good. It will nevertheless be subjected to the maximum surtax on undistributed net income.

These are only a few of the many objectionable features of this law. A recitation of all of the objectionable features, or all which could be imagined at this time, would serve no purpose. The fact remains that the Act is unfair and violates practically every sound principle of income taxation. To secure its passage a compromise was effected between the Senate and the House. Why it should be termed a compromise is not understandable because the law as passed may prove even more objectionable

(*Concluded on page 31*)

The L. R. B. & M. Journal

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The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvement; to encourage and maintain a proper spirit of cooperation and interest, and to help in the solution of common problems.

The Tax Burden

The passage of another federal tax law—the Revenue Act of 1936—naturally causes one to give renewed thought to the mounting tax burden in this country. The estimated total federal government receipts from taxes and miscellaneous sources for the fiscal year ending June 30, 1936, are expected to reach the amazing total of $4,500,000,000, setting a fifteen year Treasury record. It is further estimated that, based on the increased rates under the Revenue Act of 1936, and assuming a continuing increase in business, the total revenue of the coming government fiscal year will be larger than at any time in the history of the country, not even excepting the war years.

It is estimated that the total tax burden of the country (federal, state, and local) amounts at the present time to approximately one-fourth of the national income. This is in truth a "tax burden," and one of terrific proportions. As has been pointed out by others, it means that every employed person and every business and professional man is in effect working for the government and not for himself for at least the first day and a half of each week.

A recent cartoon in the *New York Herald Tribune* by the inimitable Webster, in his series, "Life's Darkest Moment," pictured a taxpayer with an envelope in his hand addressed to the Collector of Internal Revenue, and at the same time indulging in a dream of going fishing.* The notation on the cartoon, "The Savings for the Annual Two Weeks Vacation," emphasized the thought depicted in the cartoon. When taxation, whether direct or indirect, absorbs an unreasonable proportion of the national income, it is bound to have an effect on the standard of living and some of the things that seemed an essential part of a reasonable standard of living, not to speak of the "abundant life," are sacrificed. The inadequate realization of this fact by the average citizen is a serious aspect of the present situation in this country.

What is especially disturbing in the present situation of our governmental financial policies is not merely a record-breaking peak in the imposition of taxes, but the fact that it is accompanied by an all-time high level for the federal government debt, supplemented by a huge aggregate for the debts of states, municipalities and a host of other taxing authorities. The principle illustrated in Micawber's famous analysis of personal finance is just as applicable to governments, "annual income, twenty pounds; annual expenditure, nineteen nineteen six; result, happiness. Annual income, twenty pounds; annual expenditure, twenty pounds ought and six; result, misery."

In the final analysis, problems of tax burden and mounting debt boil down to the question of economy or extravagance in governmental expenditures. Finding sources of revenue hitherto untaxed, or "upping" existing tax rates, or duplicating taxation of the same subjects by federal, state and local governments cannot bring about a sound financial situation if the aggregate tax burden is out of proper relation to the national income. Mounting debt is a symptom of a disordered financial system. Until the fundamental cause of the disorder, namely, extravagant and unwise governmental expenditures, is corrected, there can be no cure.

* The cartoon is reproduced on page 32.

New Editions of Tax Handbooks

The passage of the Revenue Act of 1936, to a broad analysis of which this issue of the JOURNAL is devoted, and the issuance during the past year of a number of important decisions by the United States Supreme Court, as well as by the lower courts and the Board of Tax Appeals, make new editions of the Federal Income Tax Handbook by Colonel Montgomery, and of Federal Taxes of Estates, Trusts and Gifts, written by Colonel Montgomery in collaboration with Professor Magill, especially timely. The 1936-37 editions of these two books are now in course of preparation and will be published about December 1.

Natural Business Year

The Natural Business Year Council, an organization representing business men, bankers, credit men, trade associations, accountants, and others, is proceeding steadily with its study of how best to bring to the American business man an appreciation of the fact that, despite its general use, the calendar year is not the natural business year for the large majority of American businesses, and that for practically every branch of industry or commerce there is a natural business year which should be

adopted as its fiscal year. The calendar year is the natural business year for some businesses, but for others, trade conditions, operating factors, and other circumstances, make a fiscal year other than the calendar year more desirable.

The Council has prepared a tentative list of natural closing dates for a number of trades or industries. These tentative lists are being circulated for the purpose of inviting comment or criticism on the suggested dates, so that the lists when put in final form, may be circulated with the support of authority from those most conversant with conditions in the various industries. A number of trade associations are taking an active interest in this subject with a view to recommending to their members the adoption of the fiscal year which seems best suited for use in the industry represented by the association.

The 1936 Revenue Act continues the practice begun with the 1934 Revenue Act of putting fiscal year taxpayers on just as convenient a basis for making returns as those taxpayers, corporate and individual, which use the calendar year. Prior to the passage of the 1934 Act, taxpayers were permitted to make returns on the basis of a fiscal year other than the calendar year if their books were so kept, but when a new Revenue Act was passed, a computation had to be made which applied both the old and new acts to the fiscal year return to the extent that the period fell under both acts.

The present practice of having a new Revenue Act apply only to income tax years beginning after the effective date of the Act requires only one return and one computation for the fiscal year. This avoids the objection which has heretofore been made to changing from the calendar year to the natural business year by some concerns which had fully recognized the greater suitability of the latter as a basis for their accounts and financial statements.

The new undistributed profits tax furnishes an additional incentive for the adoption of a natural business year. It is easier to estimate the net income for a natural business year, and a corporation's finances will ordinarily best permit the payment of dividends at the close of a natural business year when the inventories are lowest and the cash balance highest. There would also be less possibility of overvaluing assets and thus overstating taxable income.

Complicated Taxes

A short time ago *The New York Times* contained a London dispatch reading as follows:

After having worked for eight and a half years, a committee of noted accountants and lawyers who had the task of making the income-tax laws intelligible to despairing British taxpayers, who must surrender from 20 to 60 per cent of their incomes, made public tonight a suggested "Codifying Bill." It contains 417 provisions and eight schedules, with 350 pages of explanation.

One of the committee's principal conclusions is that "income-tax legislation must by its nature be abstract and technical, and can never be easy reading."

Up to the present only the skill and ingenuity with which the income-tax authorities handle each case have kept the existing law working. Few outside the Inland Revenue Department pretend to understand the present regulations, which consist of nearly 800 separate provisions embodied in nineteen acts of Parliament.

About these statutory provisions have been attached 1,800 judicial decisions, many of which are irreconcilable because they rest on conflicting interpretations of ambiguous or incomprehensible language employed in the income-tax acts. For example, the word "assessment" is used in eight different senses, and such basic concepts as "total income" and "residence" are not defined.

Possibly, on the theory that "misery loves company," taxpayers in this country may take a bit of doubtful comfort in the thought that British taxpayers seem to be just about as much plagued by the complexities of their taxing statutes as American taxpayers. Possibly because, to use another old adage, "distance lends enchantment," there has been a tendency to consider the British system of taxation better than our own, or, at least, as being administered with less irritation to taxpayers generally than in some of our taxing jurisdictions. The above quoted dispatch is therefore all the more interesting because of its indication that this impression does not correctly reflect the situation abroad.

It is unfortunate that our taxing statutes tend to become on the whole more complex rather than simpler. This is by no means true in every detail because improvements have been effected from time to time. For example, real advance appears to have been made in reducing the overlapping and duplication between states of the taxation of estates and inheritances. From time to time inequities in the federal and other taxing statutes have been corrected, but each successive federal law seems also to produce some new complications.

Fortunately, all threatened complications do not materialize. For instance, the manner of determining the tax on the undistributed income of corporations which was proposed in the first draft of the House bill for the 1936 Revenue Act was certainly (this time quoting Holy Writ) "fearfully and wonderfully made." It looked as though it would take a combination of a Philadelphia lawyer, an actuary and a certified public accountant, with the use of higher mathematics, to determine the amount of the proposed tax applicable in a given case. In a brief filed by the American Institute of Accountants with the Senate Finance Committee, the complexity of the method of computation was illustrated by computing the tax for a corporation with a relatively small amount of net income and of undistributed net income; six pages were required to set forth the computation of the tax. Fortunately, saner councils prevailed, and the bill was radically revised, so that the mere mechanics of computing the new surtax on undistributed corporate net income should not offer any great difficulty.

The interrelation of the declaration of capital stock value and the excess-profits tax constitutes a complex situation which is troublesome to business men. It puts a premium on good guessing and "second sight."

Corporation franchise taxes imposed by the states are frequently quite complicated. In some measure this may be unavoidable because of the necessity of making allocations of income and capital employed in and out of the taxing state. The arbitrary attitude sometimes taken by taxing authorities dealing with such problems is annoying to taxpayers.

Much remains to be done, and can be done, even though it is not an easy task, to simplify our tax laws. Simplification is important, but the adoption of equitable principles in taxation is even more important. Particularly in our federal income tax law, the glaring inequities clearly outweigh the complexities.

Rates of Tax Under the Revenue Act of 1936

By H. E. Bischoff

(*New York Office*)

Taxes under the new Act become effective on the following dates:

Nature of Tax	*Effective Date*
Income tax	Taxable years beginning after December 31, 1935
Capital stock tax	Year ending June 30, 1936
Excess-profits tax	First income tax year ending after June 30, 1936
Tax on unjust enrichment ("windfall" tax)	Taxable years ending in 1935 and subsequently
Excise tax on sales—amendments	June 23, 1936
Taxes on certain oils—amendments	August 21, 1936
Withholding at source—nonresident alien individuals and foreign corporations.	July 2, 1936

In some cases the rates of prior laws (as amended by the Revenue Act of 1935) are continued under the new Act, e. g., normal and surtax on individuals, estate and gift taxes.

Income Tax on Individuals

Exemption: No change was made in the personal exemption previously allowed citizens and residents under the 1935 Act, so that they remain:

Status of Taxpayer	*Exemption*
Single	$1,000
Married or head of family	2,500
Dependents (each)	400

The personal exemption is allowed as a credit against net income for computing both the normal and surtax. In addition to the personal exemption, there is allowed as a credit against net income, for computing the normal tax only, the amount of interest received from obligations of the United States, or its corporate instrumentalities. A credit is no longer allowed for the amount of domestic dividends received, consequently such dividends are now subject to both normal and surtax.

Normal Rate: The normal income tax rate imposed under the 1934 Act, i. e., 4 per cent., is continued under the 1936 Act.

Surtax Rates: The surtax rates, which apply to "surtax net income," imposed under the Revenue Act of 1936, correspond to the rates under the 1935 Act. They are computed on a graduated scale beginning with a rate of 4 per cent. on from $4,000 to $6,000, to 75 per cent. on $5,000,000 or over of surtax net income.

The new Act revives the limitation with respect to the sale of oil and gas properties, dropped in the 1934 Act. Where the principal value of the property has been demonstrated by prospecting, exploration or discovery work by the taxpayer, the portion of the surtax on individuals attributable to the profit from such sale is not to exceed 30 per cent. of the selling price.

The following table sets forth the surtax rates for taxable years beginning after December 31, 1935. The last column shows the combined normal and surtax due on the maximum amount of net income shown in each bracket. In computing the normal tax, no credit has been allowed for "earned income" or for interest on obligations of the United States or its corporate instrumentalities.

Taxes Imposed on Income of Individuals by 1936 Revenue Act

Taxable Net Income in Excess of Personal Exemptions	*Surtax Rates*	*Surtax on Maximum Amount in Each Bracket*	*Combined Normal Tax (4%) and Surtax**
First $4,000	None	None	$ 160
$4,000 to 6,000	4 pct.	$ 80	320
6,000 to 8,000	5	180	500
8,000 to 10,000	6	300	700
10,000 to 12,000	7	440	920
12,000 to 14,000	8	600	1,160
14,000 to 16,000	9	780	1,420
16,000 to 18,000	11	1,000	1,720
18,000 to 20,000	13	1,260	2,060
20,000 to 22,000	15	1,560	2,440
22,000 to 26,000	17	2,240	3,280
26,000 to 32,000	19	3,380	4,660
32,000 to 38,000	21	4,640	6,160
38,000 to 44,000	24	6,080	7,840
44,000 to 50,000	27	7,700	9,700
50,000 to 56,000	31	9,560	11,800
56,000 to 62,000	35	11,660	14,140
62,000 to 68,000	39	14,000	16,720
68,000 to 74,000	43	16,580	19,540
74,000 to 80,000	47	19,400	22,600
80,000 to 90,000	51	24,500	28,100
90,000 to 100,000	55	30,000	34,000
100,000 to 150,000	58	59,000	65,000
150,000 to 200,000	60	89,000	97,000
200,000 to 250,000	62	120,000	130,000
250,000 to 300,000	64	152,000	164,000
300,000 to 400,000	66	218,000	234,000
400,000 to 500,000	68	286,000	306,000
500,000 to 750,000	70	461,000	491,000
750,000 to 1,000,000	72	641,000	681,000
1,000,000 to 2,000,000	73	1,371,000	1,451,000
2,000,000 to 5,000,000	74	3,591,000	3,791,000
Over 5,000,000	75		

* Before applying credit for "Earned Income" or any credits for interest on U. S. obligations, etc., allowed under Section 25.

Income Tax on Corporations

Normal Tax: The normal tax is imposed on "normal-tax net income" as defined in the law. The method of arriving at normal-tax net income is described more fully in another article of this issue (see page 1).

The new rates which apply to taxable years beginning after December 31, 1935, are slightly lower than those imposed under the Revenue Act of 1934, as amended by the 1935 Act, and are as follows:

Amounts of Normal-Tax Net Income	*Rates of Normal Tax*	*Total Tax*
Not in excess of $2,000	8 per cent.	$ 160
$2,000 to $15,000	11 do.	1,590
$15,000 to $40,000	13 do.	4,840
Over $40,000	15 do.	

In those cases where the normal-tax net income is in excess of $40,000, the rate of 15 per cent. is applied to such excess and added to $4,840 in order to obtain the total normal tax.

Example: Assuming a corporation with normal-tax net income of $140,000 for the calendar year 1936, the total tax would amount to $19,840, computed as follows:

Accumulated tax on first $40,000	$4,840
Tax on remaining $100,000 at 15 per cent	15,000
Total tax	$19,840

Banks, trust companies and insurance companies as defined in the Act

are not subject to the surtax imposed upon undistributed net income, and, in lieu of the rates mentioned above, the normal tax is imposed at the rate of 15 per cent. on their entire taxable net income.

Foreign corporations: For resident-foreign corporations the rate is 22 per cent. instead of the regular corporation normal tax rate.

In the case of foreign corporations neither doing business, nor having an office, in the United States the rate is 15 per cent. on income from United States sources, other than from dividends on which the rate is 10 per cent. In the case of Canadian or Mexican corporations the rate on dividends may be reduced by treaty to not less than 5 per cent.

Neither resident nor non-resident foreign corporations are subject to the surtax on undistributed net income.

Consolidated Returns: Consolidated returns are permitted for railroad companies only, but, unlike the Revenue Act of 1934, which imposed a different rate of normal tax in the case of consolidated returns (15¾ per cent.), under the 1936 Act the same rates apply to consolidated as to separate returns.

Surtax on Undistributed Income

In addition to the normal tax common to prior laws, the 1936 Act injects a new feature in the form of a surtax on undistributed net income.

The method of arriving at "adjusted net income" and "undistributed net income" (the factors used in computing the surtax) is described in another article of this issue (see page 2).

The amount of "undistributed net income" is made the basis of the surtax which is computed at a graduated scale of rates. The amounts to which the respective rates apply are arrived at by applying the percentages shown below (in the first column) to the "adjusted net income," not to "undistributed net income."

The rates of surtax on undistributed net income follow:

Percentages of Adjusted Net Income	*Rates of Surtax*
First 10 per cent.	7 per cent.
10 to 20 per cent.	12 per cent.
20 to 40 per cent.	17 per cent.
40 to 60 per cent.	22 per cent.
Over 60 per cent.	27 per cent.

Where the "adjusted net income" is the same as the "undistributed net income" (as, for example, when no dividends have been paid), the net effect of the above table is to impose a tax of 20½ per cent. of adjusted or undistributed net income.

The ratio of surtax to "undistributed net income," and to "adjusted net income" (if in excess of $50,000), assuming dividends are paid at the varying percentages shown in the table, would be as follows:

Percentages of Adjusted Net Income Paid in Dividends	*Ratios of Surtax to "Undistributed Net Income"*	*Ratios of Surtax to "Adjusted Net Income"*
100 per cent.	None	None
90 do.	7 per cent.	.7 per cent.
80 do.	9.5 do.	1.9 do.
70 do.	12. do.	3.6 do.
60 do.	13.25 do.	5.3 do.
50 do.	15. do.	7.5 do.
40 do.	16.16 do.	9.7 do.
30 do.	17.71 do.	12.4 do.
20 do.	18.87 do.	15.1 do.
10 do.	19.77 do.	17.8 do.
None	20.5 do.	20.5 do.

The above illustrates the tax advantage to be gained in the ordinary case through the payment as dividends of a large percentage of adjusted net income. For example, if 50 per cent. of the adjusted net income is paid out in dividends the effect is to reduce the surtax from 20.5 per cent. (assuming no dividends were paid) to 7.5 per cent. of adjusted net income, or 15 per cent. of the amount of adjusted net income retained.

Example: Assuming a corporation reported "adjusted net income" of $500,000 and "undistributed net income" of $320,000, the surtax on undistributed net income would amount to $53,900, as computed below:

Percentages of Adjusted Net Income	*Amounts of Undistributed Net Income in Each Bracket*	*Rates of Surtax*	*Amounts of Tax on Undistributed Net Income*
First 10 per cent....	$ 50,000	7 per cent.	$ 3,500
10 to 20 do.	50,000	12 do.	6,000
20 to 40 do.	100,000	17 do.	17,000
40 to 60 do.	100,000	22 do.	22,000
Over 60 do.	20,000	27 do.	5,400
	$320,000		$53,900

Specific Credit: In those cases where corporations report "adjusted net income" of less than $50,000, a specific credit is allowed which has the effect of taxing up to $5,000 of the "undistributed net income" at the lowest rate of 7 per cent., regardless of how small the amount in the lowest bracket (10 per cent. of adjusted net income) would otherwise be.

Example: Assuming a corporation reporting "adjusted net income" of $40,000 and "undistributed net income" of $28,000, the surtax on undistributed net income would amount to $4,760, as computed below in accordance with Section 14 (c):

Undistributed net income........................	$28,000
Less, specific credit:	
Portion of undistributed net income which exceeds 10 per cent. of $40,000, i. e., $4,000, and is not in excess of $5,000...........................	1,000
Undistributed net income, less specific credit.......	$27,000

Percentages of Adjusted Net Income	*Amounts of Undistributed Net Income in Each Bracket*	*Rates of Surtax*	*Amounts of Tax on Undistributed Net Income*
First 10 per cent....	$ 4,000	7 per cent.	$ 280
10 to 20 do.	4,000	12 do.	480
20 to 40 do.	8,000	17 do.	1,360
40 to 60 do.	8,000	22 do.	1,760
Over 60 do.	3,000	27 do.	810
Specific credit......	1,000	7 do.	70
	$28,000		$4,760

The surtax in the above example without the benefit of the specific exemption would be $4,960, or $200 greater.

Exemptions: Certain special exemptions from the surtax on undistributed income are granted banks, corporations in bankruptcy, etc., as specified in Section 14 (d) of the Act.

Surtax on Personal Holding Companies: In addition to the normal tax and the surtax on undistributed net income, the new Act continues the special surtax on personal holding companies, but at changed rates. The new rates are as follows:

Undistributed Adjusted Net Income	*Rates of Surtax*	*Total Tax on Maximum Amount in Respective Brackets*
Not in excess of $2,000.....	8 per cent.	$ 160
$2,000 to $100,000.........	18 do.	17,800
$100,000 to $500,000.......	28 do.	129,800
$500,000 to $1,000,000.....	38 do.	319,800
In excess of $1,000,000.....	48 do.	....

Surtax on Corporations Improperly Accumulating Surplus: Important changes from prior laws have been made with reference to the surtax on corporations improperly accumulating surplus. This tax, which is in addition to the normal tax and the surtax on undistributed profits, is computed on the "retained net income" at the following rates:

In the Case of Corporations Not Subject to Surtax on Undistributed Income

Retained Net Income	*Rates of Surtax*
Not in excess of $100,000.................	25 per cent.
In excess of $100,000......................	35 do.

In the Case of Corporations Which Are Subject to Surtax on Undistributed Income

Retained Net Income	*Rates of Surtax*
Not in excess of $100,000.................	15 per cent.
In excess of $100,000......................	25 do.

Capital Stock Tax

New Declaration of Value: Irrespective of the declared or adjusted declared value used for previous capital

stock tax returns, every corporate taxpayer is permitted to make a new declaration of value of its capital stock for the year ending June 30, 1936.

Rate of Tax: The capital stock tax under the new Act is at the rate of $1 per $1,000 of declared capital stock value. This is a reduction from the rate of $1.40 imposed by the 1935 Act.

Excess-Profits Tax

Rates: The rates imposed by the 1935 Act are retained in the new Act. Accordingly, for taxable years ending after June 30, 1936, the excess-profits tax on corporations will be computed as follows:

6 per cent. of such portion of a corporation's net income for its income tax year as is in excess of 10 per cent. and not in excess of 15 per cent. of the adjusted declared value of its capital stock at the close of its preceding income tax year, and

12 per cent. of such portion of a corporation's net income for its income tax year as is in excess of 15 per cent. of the adjusted declared value.

Deductions from Net Income: Although the 1935 Revenue Act allowed the deduction of the income tax from the taxable net income in arriving at the amount subject to excess-profits tax, this deduction is not allowed under the new Act. However, a deduction from net income of 85 per cent. of dividends received from corporations subject to income tax is allowed in order to arrive at the basis for the excess-profits tax, and the excess-profits tax may now be deducted in determining net income subject to income tax.

Example: Assume that for the year ending June 30, 1936, the A corporation declared a value of $1,000,000 for its capital stock and that its taxable net income (less the credit for dividends) for the calendar year ending December 31, 1936, amounts to $200,000.

The capital stock tax will be $1 per $1,000 on declared value of $1,000,000, or $1,000.

The excess-profits tax will amount to $9,000, computed as follows:

Percentages of Declared Value	*Income Brackets*	*Excess-Profits Tax Rates*	*Amount of Tax*
10 per cent...........	$100,000	None	None
5 do.	50,000	6 per cent.	$3,000
Over 15 per cent......	50,000	12 do.	6,000
Totals...........	$200.000		$9.000

The total capital stock tax and excess-profits tax under the above example amounts to $10,000. If a value of $2,000,000 had been declared for the capital stock instead of $1,000,000, the capital stock tax (there would be no excess-profits tax) would amount to $2,000, or $8,000 less than the total capital stock and excess-profits tax based on a declared value of $1,000,000.

The foregoing demonstrates how essential it is that careful consideration be given to the value declared for capital stock tax purposes so as to reduce to a minimum the amount of excess-profits tax.

Estate Tax

The estate tax rates imposed under the 1926 Act and the 1932 Act (as amended in 1935) remained unchanged by the 1936 Act and accordingly apply to transfers of estates of decedents dying after August 30, 1935 (date of enactment of 1935 Act).

Exemption: A specific exemption of $40,000 is allowed for computing the estate tax under the amended 1932 Act. For the purpose of computing the estate tax under the 1926 law, the exemption remains the same at $100,000.

Method of Computation: As heretofore, two separate computations are required in order to arrive at the total estate tax, namely, (1) using an exemption of $100,000 and the tax rates under the 1926 Act for the purpose of arriving at a base for computing the maximum credit (80 per cent. of such base) for state inheritance and estate taxes, and (2) using an exemption of $40,000 and the rates under the amended 1932 Act, from which amount there is deducted the tax computed under the 1926 Act (before deducting from the latter the credit for state tax). The amount remaining, after deducting from (1) the credit for state inheritance tax, is added to (2) to arrive at the total tax.

The following table shows the rates applicable under the 1926 and amended 1932 Revenue Acts. Attention is drawn to the fact that the figures shown in the first two columns are after deducting the exemptions applicable under the different laws as stated at the top of the schedule. The amount of tax shown in each bracket is based upon the maximum value of the net estate in such bracket:

ESTATE TAX RATES

EXEMPTION UNDER 1926 LAW.......................... $100,000
EXEMPTION UNDER 1932 LAW (as amended in 1935)...... 40,000

Value of Net Estate After Deducting Exemptions as Stated Above	*1926 Law*		*1932 Law (as amended)*	
	Rates of Tax	*Amounts of Tax*	*Rates of Tax*	*Amounts of Tax*
$ 0 to $ 10,000......	1 Pct.	$ 100	2 Pct.	$ 200
10,000 to 20,000......	1	200	4	600
20,000 to 30,000......	1	300	6	1,200
30,000 to 40,000......	1	400	8	2,000
40,000 to 50,000......	1	500	10	3,000
50,000 to 70,000......	2	900	12	5,400
70,000 to 100,000......	2	1,500	14	9,600
100,000 to 200,000......	3	4,500	17	26,600
200,000 to 400,000......	4	12,500	20	66,600
400,000 to 600,000......	5	22,500	23	112,600
600,000 to 800,000......	6	34,500	26	164,600
800,000 to 1,000,000......	7	48,500	29	222,600
1,000,000 to 1,500,000......	8	88,500	32	382,600
1,500,000 to 2,000,000......	9	133,500	35	557,600
2,000,000 to 2,500,000......	10	183,500	38	747,600
2,500,000 to 3,000,000......	11	238,500	41	952,600
3,000,000 to 3,500,000......	12	298,500	44	1,172,600
3,500,000 to 4,000,000......	13	363,500	47	1,407,600
4,000,000 to 4,500,000......	14	433,500	50	1,657,600
4,500,000 to 5,000,000......	14	503,500	53	1,922,600
5,000,000 to 6,000,000......	15	653,500	56	2,482,600
6,000,000 to 7,000,000......	16	813,500	59	3,072,600
7,000,000 to 8,000,000......	17	983,500	61	3,682,600
8,000,000 to 9,000,000......	18	1,163,500	63	4,312,600
9,000,000 to 10,000,000......	19	1,353,500	65	4,962,600
10,000,000 to 20,000,000......	20	3,353,500	67	11,662,600
20,000,000 to 50,000,000......	20	9,353,500	69	32,362,600
Over 50,000,000......	20		70	

Example: Assume A died June 25, 1936, leaving a net estate (before specific exemptions) of \$500,000 and that he is entitled to the maximum credit allowed for state inheritance tax. The total estate tax payable would amount to \$70,400, computed as follows:

Tax Computed Under 1926 Act

Net estate	\$500,000	
Less, Exemption	100,000	
Net estate after exemption	\$400,000	
Tax on \$400,000 at 1926 rates	\$12,500	
Less, Credit for state inheritance tax, 80 per cent. of \$12,500	10,000	
Net tax under 1926 act		\$2,500

Tax Computed Under 1932 Act (as amended in 1935)

Net estate	\$500,000	
Less, Exemption	40,000	
Net estate after exemption	\$460,000	
Tax on \$460,000 at 1932 rates (as amended)	\$80,400	
Less, Tax at 1926 rates	12,500	
Additional tax under 1932 Act (as amended)		67,900
Total estate tax		\$70,400

Gift Tax

The gift tax rates imposed under the 1932 Act, as revised by the 1935 Act, were not changed by the 1936 Act.

Effective Date: The increased rates apply to gifts made on and after January 1, 1936.

Exemptions: The specific exemption of \$40,000 contained in the 1935 Act is continued under the 1936 Act. The \$5,000 exemption allowed for gifts (other than future interest in property) made to any person during any taxable year remains unchanged.

Rates: The tax is cumulative and advances to the higher brackets as the total value of all taxable gifts increases from year to year.

In computing the tax for 1936 the taxable gifts made in 1936 are added to the total of taxable gifts made up to December 31, 1935. A tax at the 1936 rates is computed on the grand total. There is then deducted from the tax thus arrived at, a tax computed at the 1936 rates on the accumulated gifts to December 31, 1935, and the difference between the two tax computations is the tax on the 1936 gifts. A similar procedure will be followed in the years following 1936.

The table on the next page shows the rates under the 1932 Act, as amended in 1935, which are applicable to 1936 and later years. The amounts of tax shown have been computed on the maximum amounts of taxable gifts in the respective brackets.

Example: Assume that from June 7, 1932 (enactment of 1932 Revenue Act) to December 31, 1935, inclusive, B made net gifts of \$140,000, or \$100,000 in excess of the \$40,000 specific exemption, and that during 1936 he makes further net gifts of \$100,000. The tax due on the 1936 gifts would amount to \$12,750, computed as follows:

Net gifts to December 31, 1935 (\$140,000 less \$40,000)	\$100,000
Additional net gifts in 1936	100,000
Total accumulated gifts	\$200,000
Tax on accumulated gifts of \$200,000 at 1936 rates	\$19,950
Less, Tax on accumulated gifts of \$100,000 to December 31, 1935, at 1936 rates	7,200
Tax on 1936 gifts	\$12,750

Withholding at Source

In the case of nonresident alien individuals not engaged in trade or business in the United States, and not

GIFT TAX RATES

EXEMPTION.............................. $40,000

Net Gifts in Excess of Exemption as Stated Above	Rates of Tax	Total Tax
$ 0 to $10,000	1½ Pct.	$ 150
10,000 to 20,000	3	450
20,000 to 30,000	4½	900
30,000 to 40,000	6	1,500
40,000 to 50,000	7½	2,250
50,000 to 70,000	9	4,050
70,000 to 100,000	10½	7,200
100,000 to 200,000	12¾	19,950
200,000 to 400,000	15	49,950
400,000 to 600,000	17¼	84,450
600,000 to 800,000	19½	123,450
800,000 to 1,000,000	21¾	166,950
1,000,000 to 1,500,000	24	286,950
1,500,000 to 2,000,000	26¼	418,200
2,000,000 to 2,500,000	28½	560,700
2,500,000 to 3,000,000	30¾	714,450
3,000,000 to 3,500,000	33	879,450
3,500,000 to 4,000,000	35¼	1,055,700
4,000,000 to 4,500,000	37½	1,243,200
4,500,000 to 5,000,000	39¾	1,441,950
5,000,000 to 6,000,000	42	1,861,950
6,000,000 to 7,000,000	44¼	2,304,450
7,000,000 to 8,000,000	45¾	2,761,950
8,000,000 to 9,000.000	47¼	3,234,450
9,000,000 to 10,000,000	48¾	3,721,950
10,000,000 to 20,000,000	50¼	8,746,950
20,000,000 to 50,000,000	51¾	24,271,950
Over 50,000,000	52½	

having an office or place of business therein, tax is to be withheld on income from United States sources at the rate of 10 per cent., except in the case of a resident of Canada or Mexico, where the rate may be reduced by treaty to not less than 5 per cent.

In the case of a foreign corporation not engaged in trade or business within the United States and not having an office or place of business therein, tax withheld at the source is at the rate of 15 per cent., except as to dividends, for which the rate is 10 per cent. In the case of Canadian or Mexican corporations the rate on dividends may be reduced by treaty to not less than 5 per cent.

No withholding is required in the case of resident foreign corporations.

Tax on Unjust Enrichment

This tax, commonly referred to as the "Windfall Tax," is treated in detail in another article of this issue (see page 10).

Miscellaneous Taxes

Effective August 21, 1936, the import tax on certain oils, more fully described in Section 701 of the Act, will be as follows:

Certain vegetable oils...4½ cents per pound
Certain seeds..........2 cents per pound

Effective after June 22, 1936, the tax on jewelry imposed by Section 605 of the 1932 Act is no longer applicable. The rate of tax on furs has been reduced from 10 per cent. to 3 per cent., and the $75 exemption eliminated.

New Provisions of Law

(*Continued from page 9*)

reported in the returns of shareholders other than corporations.

Common Trust Funds

A "common trust fund" is defined in the new law as "a fund maintained by a bank (1) exclusively for the collective investment and reinvestment of moneys contributed thereto by the bank in its capacity as a trustee, executor, administrator, or guardian, and (2) in conformity with the rules and regulations, prevailing from time to time, of the Board of Governors of the Federal Reserve System pertaining to the collective investment of trust funds by national banks." Under prior law if such funds constituted "associations" they were taxed as corporations. The new law exempts such funds from corporate taxes. The income is made taxable to the participants in the fund, whether or not distributed or distributable. A withdrawal by a participant is treated as a closed transaction to the participant, but no gain or loss is realized by the fund from the admission or withdrawal of a participant.

Sale of Oil or Gas Properties

Under the new law, in the case of a sale of oil or gas property where the value resulted from the taxpayer's prospecting, exploration, or discovery work, the individual surtax attributable to such sale is limited to 30 per cent. of the sale price.

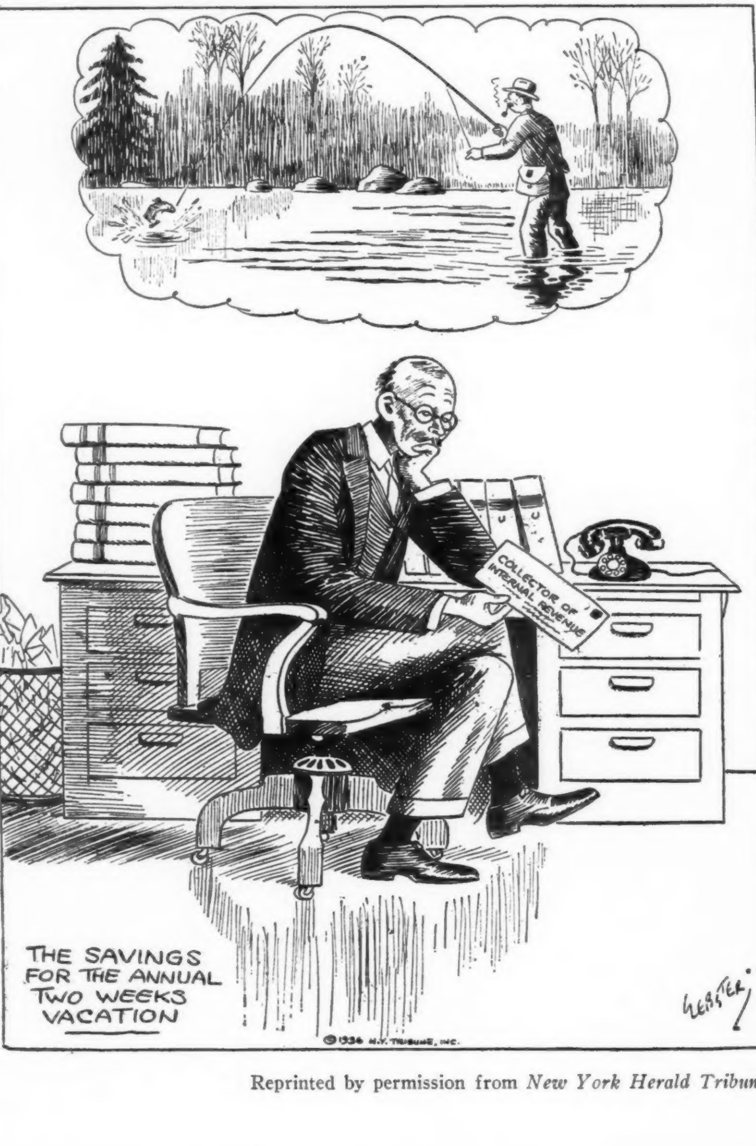
Hardships and Inequities in the 1936 Tax Law

(*Continued from page 18*)

than the Bill originally passed by the House.

The House Bill imposed no normal tax on corporations. Such normal tax was transferred to the stockholders. The only tax a corporation was required to pay was the undistributed net income tax. In many instances it would pay nothing. Under the law as "compromised" the undistributed net income tax is retained; the corporation is required to pay a normal tax on its entire net income, and the stockholder is also required to pay a normal tax on all dividends received. Thus, in effect, under the law as passed there is a double normal tax on corporate earnings distributed, whereas under the House Bill such earnings bore only a single normal tax. True it is that the undistributed net income rates are not as high in the present law as they were in the House Bill. Nevertheless, the corporation which distributes all of its adjusted net income, and its stockholders, will pay higher taxes under the law as passed than they would have under the House Bill.

Life's Darkest Moment : : : BY WEBSTER



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